Greater Kansas City Community Foundation

5-YEAR PAYOUT RULE FOR DONOR ADVISED FUNDS

Donor Stories illustrating how the 5-year payout rule would adversely affect giving

- **Forcing larger grants sooner can cripple smaller/newer organizations –** We have one donor who made millions later in life who is using a DAF to support organizations over time, both through current distributions and planned distributions after the donor's death. If he was forced to pay out his DAF assets within 5 years, the organizations he supports would receive significantly larger grants than what they are used to. A large grant can cripple an organization if the organization is not equipped to handle it. It can also deter other donors from supporting the organization if they believe one donor has covered the organization's needs.

- **Forcing a payout ignores charitable intent –** Another wealthy donor established a fund to benefit an organization through annual distributions to the organization. The donor was concerned the organization may not be in existence after its current president and founder retires. Rather than giving the money directly to the organization in a lump sum, the donor is using a fund to spread out the distributions and to plan for alternate distributions to similar types of organizations in the event the original organization should cease to exist. The donor is also relying on the Community Foundation to monitor the use of the money to ensure his charitable intent is honored. The 5-year payout rule would force a distribution that is not consistent with the donor's intent.

- **Requiring a 5-year payout discourages donors from planning for future giving –** Even donors of more modest means like to plan ahead for their giving. A young family has a DAF that they are currently funding with the intent that they will use the fund later to introduce their children to philanthropy. They are setting aside smaller amounts of money now so that they can have a more substantial fund down the road when their children are ready to give through the fund. Other donors like the flexibility of DAF's as a vehicle to save for larger grants in the future. For example, it might take longer than 5 years to be in a position to endow a chair at a university or make a contribution that qualifies for naming rights. If a donor is forced to distribute the assets in their DAF within 5 years of a contribution, they may be discouraged from engaging their family in using the DAF or from making that larger grant to an organization.

3238 P Street, NW ▪ Washington, DC 20007
(703) 623-7317 TEL ▪ (202) 342-1904 FAX
www.dsquaredtax.com

- **A 5-year payout can limit a donor's ability to respond to a changing community –** A donor may have a specific purpose for their donor advised fund that they intend future generations of donor advisors to honor. Sometimes that stated purpose must evolve to fit the current circumstances of a community which can take time to determine. A mandatory 5-year payout would make it difficult for the Community Foundation and donor advisors to interpret and implement the donor's intent in response to the changing community.

<u>Reasons the 5-year payout proposal doesn't make good sense</u>

- **Tracking issues for sponsors of donor advised funds –** Sponsors of donor advised funds would be required to reapply their resources to monitor and track how long each contribution to a donor advised fund is held to make sure the fund complies with the 5-year payout rule. This would be a major issue for smaller organizations with limited staff as well as for larger organizations with hundreds/thousands of donor advised funds. It would likely require investment in software to ensure accurate tracking and notification systems. Given the relatively low amount of money expected to be generated by this rule, this added burden on sponsors of donor advised funds just doesn't make sense.

- **DAF's are already subject to the excess business holdings rule –** DAF's must already comply with the excess business holdings rule which generally requires a DAF that has received closely held business interests above a certain threshold amount to liquidate those interests below that threshold within 5 years of receipt of the interests. This adequately addresses the concern that a DAF with illiquid assets cannot make grants. A broader 5-year rule is not needed and jeopardizes giving as illustrated in our donor stories.

- **If the rule applies to DAF's, will they do the same for private foundations?** - The Pension Protection Act of 2006 attempted to level the playing field a bit between DAF's and PF's by applying some of the private foundation excise taxes to DAF's. If they really want to make sure assets are not held in a charitable vehicle but are rather distributed directly out to the community, then they should apply the same rule to private foundations. Do they really want to knock on the Gates Foundation's door and require them to comply with this rule?

<u>Cap On Charitable Deductions</u>

The Greater Kansas City Community Foundation has been helping individuals, families and companies give to charity for 35 years. Established in 1978, our founders believed that charitable giving should be the responsibility of many, not just a select few, and this is still true today as we continue to work with philanthropists in all tax brackets. With an asset base of $1.7 billion in more than 3,300 funds, the Greater Kansas City Community Foundation has ranked among the top 10 community foundations in the country since 1999, based on annual contributions, annual grants and asset size.

Donors at the Community Foundation give year-round, but the bulk of the activity is consistently in the 4th quarter, especially December, when donors are facing tax-related deadlines. In 2012, the Community Foundation received more than $300 million in new donations[1]. Approximately half (49 percent) of new donations came in the 4th quarter, and 39 percent came in December. Looking back five years prior (2007 through 2011), the average percentage of gifts received in the last quarter remains essentially the same at 48 percent. More relevant statistics related to year-end giving:

	Per Year based on Average 2007-2011			
	Dollars	**% of Total for the Year**	**Number**	**Average Size**
Gifts received in December	$59.5 million	30%	5,790	$9,243
Gifts received in 4th quarter	$92.2 million	48%	13,589	$7,015
Stock gifts received in December	$16.2 million	28%	103	$157,282
Stock gifts received in 4th quarter	$32.4 million	56%	152	$213,158
New funds (accounts) opened in December		38%	66	

	2012[1]			
	Dollars	**% of Total for the Year**	**Number**	**Average Size**
Gifts received in December	$118.3 million	39%	3,800	$29,094
Gifts received in 4th quarter	$150.4 million	49%	8,079	$14,799
Stock gifts received in December	$27.1 million	28%	156	$173,718
Stock gifts received in 4th quarter	$39.9 million	41%	248	$160,887
New funds (accounts) opened in December		61%	102	

It's apparent that a change to the itemized deduction for charitable contributions would dramatically affect the level of charitable giving, not just at the Greater Kansas City Community Foundation, but throughout the national nonprofit community. The Community Foundation's mission is to increase charitable giving, and favorable tax laws are fundamentally important to that mission.

[1] excludes a significant and unique bequest